REPORT OF THE COMMISSION ON A CAFETERIA-STYLE BENEFITS PROGRAM FOR TEACHERS AND STATE EMPLOYEES

REPORT TO THE 1985 GENERAL ASSEMBLY OF NORTH CAROLINA

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STATE OF NORTH CAROLINA

LEGISLATIVE COMMISSION

ON A CAFETERIA-STYLE BENEFITS PROGRAM

FOR TEACHERS AND STATE EMPLOYEES

STATE LEGISLATIVE BUILDING

RALEIGH 27611

January 10, 1985

TO THE SPEAKER OF THE HOUSE OF REPRESENTATIVES AND THE PRESIDENT PRO-TEM OF THE SENATE:

This is the Commission on a Cafeteria Style Benefits Program for Teachers and State Employee's report for transmittal to the 1985 General Assembly. This report is made pursuant to Section 12 of 1983 Session Laws Chapter 1112 and is transmitted by the Commission for the General Assembly's consideration.

Respectfully submitted,

Margaret B. Hayden,
Representative

Lura Tally,
Senator

Cochairpersons

Commission on a Cafeteria Style
Benefits Program for
Teachers and State Employees

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BACKGROUND

On May 11, 1984 Representative Margaret B. Hayden introduced House Joint Resolution 1032 authorizing the Legislative Research Commission to study the feasibility of establishing a cafeteria-style benefits program for all teachers and state employees. That bill, cosigned by Representatives Brennan, Easterling, Gentry, Hauser, Quinn and Thomas, was referred to the House Rules Commission from which it was favorably reported on May 19, 1984. The bill was then rereferred to the Appropriations Commission and was subsequently enacted, in a modified form, as Section 12 of Chapter 1112 of the 1983 Session Laws (See Appendix A).

The specific legislative mandate of this study commission is found at Section 12(b) which reads:

"(b) The Commission on a Cafeteria-Style Benefits Program for Teachers and State Employees shall study the feasibility of establishing a cafeteria-style benefits program for all teachers and State employees. The Commission shall study the current benefits offered by the State to determine which, if any, of these benefits could be incorporated into a cafeteria-style benefits program and shall also study benefits not offered by the State to determine whether additional benefits could be offered through a cafeteria-style benefits program. The Commission shall determine the dollar amount of benefits that could be allocated to each employee under a cafeteria-style benefits program and the

cost to the employee of each benefit that could be included in this type program. The Commission shall consider whether any restrictions, such as a specified waiting period or a physical examination, should apply to the selection of any benefits."

The Commission consists of five Representatives and five Senators with Representative Margaret B. Hayden and Senator Lura Tally serving as Cochairpersons (See Appendix B for a list of the Commission members).

The Commission is required by Section 12(g) to report to the General Assembly on or before February 15, 1985.

MEETINGS

The Commission held four meetings on October 12, 1984, November 20, 1984, December 14, 1984, and January 10, 1985.

At the first meeting the Commission considered the results of an informal survey of the other forty-nine states, of private industry, and of local governments, both in North Carolina and nationally, conducted by the Commission staff. The Commission heard from the Office of State Personnel and the Department of Public Instruction concerning current employee benefits, and spokesmen from organizations representing state employees, teachers, and school administrators. The Commission also considered various information ranging from newspaper and magazine articles concerning cafeteria-style benefit plans to recent federal tax law amendments and regulations, in order to better define the scope of the study. (See Appendix C for a list of all persons making presentations to the Commission during its deliberations.)

At the second meeting the Commission considered the cafeteria-style benefit plans currently in existence in North Carolina and elsewhere, and heard presentations from a consulting firm which assists clients in establishing cafeteria-style benefit programs and from the Urban Center at North Carolina State University, to determine the feasibility of surveying state employees and teachers concerning their needs and desires for a cafeteria-style benefit program. The Commission heard a presentation from representatives of the County of Catawba which has recently implemented a cafeteria-style benefit program, which apparently is the only county cafeteria-style benefit program in the United States.

At the third meeting the Commission heard a presentation from a representative from the Office of State Personnel concerning its 1984 survey of state employees concerning the need for day-care benefits. The Commission heard a brief report from the Commission Counsel concerning relevant recommendations made by the Legislative Research Commission study committees. The Commission gave the staff instructions for the preparation of a report containing its findings and recommendations.

At the fourth meeting the Commission approved this report to the 1985 General Assembly.

(For details of all presentations and deliberations see the minutes of the Commission meetings which are on file in the Legislative Library.)

DISCUSSION

***Costs

The following statistics put the issue of employee benefits in perspective:

- Nationally, total employee benefits have grown from $644 per year per employee in 1951 to $7,187 in 1982. The most dramatic increases have occurred in the last decade when the cost of benefits almost tripled from $2,544 to $7,187.

- The State of North Carolina spends approximately $6,500, on average, for benefits of each employee and teacher annually.

- Nationally, average annual benefit payments per employee rose 495 percent between 1959 and 1980 while average wages rose 231 percent.

- Nationally, in 1959, benefits accounted for 24.7 percent of payroll; by 1980 they had risen to 41.4 percent of payroll.

- Nationally, in round numbers, the total price tag for benefits paid by employers was $510 billion in 1982, $550 billion in 1983, and is estimated to be about $595 billion for 1984, a 16.7 percent increase over two years.

***Work Force

The benefits package offered to most employees was designed for the "average employee" of the fifties. He was a middle-aged man with a wife and 2.4 children at home. Today this "average" worker makes up less than 20 percent of the labor force. It has been estimated by the U. S. Department of Labor that by 1990, 47% of the work force will be female and almost four-fifths of these women will become pregnant during their working lives. By the

1990's almost half of the labor force will have children under 18 years of age and in two-thirds of these families, both parents will be employed. In addition to working parents, the work force consists of a diverse group of single people, married people without children, and older people both married and single.

Among the reasons for the increased costs of benefits and for the changing demographics of the work force is economic inflation. Inflation has not only increased benefit costs and caused more two-worker families, but it has also made employees more aware of the cost of their benefits to the employer and the value of their benefits to themselves. They have become aware that there are differences between pre-tax costs to the employer and to the employee and after-tax contributions by the employee and they are aware of the possibilities of the tax sheltering of current income so that marginal tax rates will be lower both now and when they receive the sheltered money later on.

In sum, the employee of the 80's, both nationally and in North Carolina, is much more aware of potential benefit options and therefore seems less likely to be satisfied with the standard benefit package made available to all employees regardless of individual needs or preferences on a "take-it or leave-it" basis.

The initial responses to dissatisfaction with the standard benefit package for employees came in the private sector. Educational Testing Service began a review of its employee benefits in 1971 and instituted a "cafeteria style" or flexible benefit program in 1974. ETS presently offers a core package of benefits paid for by the employer to all employees and allows

each employee credits equal to a certain percentage of their salary depending on length of service with which to "purchase" any of 16 benefit options which range from a mutual fund to dental care to several retirement options. ETS also allows its employees to convert these benefit credits into cash wages.

***Definitions

There are several terms which should be considered, at the outset. "Cafeteria-style benefits" or "flexible benefits" allow the employee to select from the "menu" of various benefit options up to a certain cost. There are "total cafeteria-style programs" where the employee chooses all of the options or cash. There are "limited cafeteria-style programs" where employers provide a core of benefits, such as some health insurance, vacation leave, sick leave, and some retirement benefits and the employees are permitted to spend the savings from this reduced package on other benefits selected from the "menu".

Two terms which should be distinguished are "flexible benefit programs" and "flexible compensation programs". The former, as previously described, allows the employee flexibility in determining the use of pre-tax dollars spent by the employer for the employee's benefit, but not taxed to the employee. The latter are pre-tax dollars which are owed to the employee as wages or other compensation but which are sheltered through procedures established by the employer such as additional, voluntary, contributions to pension programs like the 401K program which has already been established by the General Assembly. Flexible benefit programs also provide for additional,

voluntary, contributions of employee after-tax income for employer-established and managed programs providing group life insurance or group dental insurance, for example.

Another term which must be considered is "ZEBRA" which is a commonly used acronym for "flexible spending arrangements" in which the employer establishes an account for each employee and places in that account benefit credits equal to a certain dollar figure which can be spent by the employee to reimburse himself or herself for payments made for recognized purposes such as medical care, dental care, or child care. These ZEBRA accounts have been the subject of many income tax decisions and rulings, the problem being that the disapproved plans have allowed the employee to convert the benefit credits remaining in the benefit account at the end of the benefit year to cash. The Internal Revenue Service has ruled that any credits remaining at the end of the benefit year, usually the fiscal year, must be forfeited to the employer by the employee.

As can be seen from the above descriptions and definitions, the tax consequences of the use of various funds for different purposes plays a big role in the utility of any cafeteria-style benefit program. The 1978 and 1980 tax laws improved the potential of flexible benefit plans by allowing more benefits to have tax-favored basis. The Internal Revenue Service has only recently released detailed regulations concerning flexible benefit packages. These regulations are subject to change as a result of the proposed flat-tax initiatives. The Treasury Department's proposal would allow deductions for certain minimum employee

benefits and then tax all other benefits as income to the employee.

A survey of all 50 states, conducted by the Commission staff, found that there are no states with currently operational flexible benefit programs and that those states that have considered studying plans have postponed action until the tax questions have been answered.

Finally, many of the costs of employee benefits now paid by the State of North Carolina are mandated either by federal law (such as Social Security and unemployment compensation) or by state statutes (such as health insurance and retirement). There is an obvious interrelationship between existing statutes and a cafeteria-style benefit program which must be carefully considered before any program can be implemented. Alaska has opted out of the Social Security system for its employees, possibly in an attempt to "free-up" funds for a cafeteria-style benefits program for its employees.

FINDINGS AND RECOMMENDATIONS

The Commission finds that it is possible to establish a cafeteria-style benefit program for North Carolina employees and teachers but that careful consideration must be given to the policy issues that surround the establishment of such a program.

The Commission recommends that the study of a cafeteria-style benefit program for teachers and state employees be continued and that it should be properly funded to allow the Commission to determine the benefit needs of the teachers and state employees. The Commission further recommends the addition

of four non-legislator members, two appointed by the Speaker of the House of Representatives and two appointed by the President Pro-Tem of the Senate, these members to have expertise about employee benefits or cafeteria-style benefit programs. (See Appendix D for proposed legislation to implement this recommendation.)

The Commission finds that the Revenue Laws Study Committee of the Legislative Research Commission is recommending legislation to modify the North Carolina child care tax credit, which has, through the process of amendment of the Internal Revenue Code, become less favorable than the federal provision it was supposed to track.

The Commission recommends that the General Assembly ratify the bill being proposed by the Revenue Laws Committee of the Legislative Research Commission to amend Chapter 105 of the General Statutes to make the North Carolina child care tax credit equal to that provided by the Internal Revenue Code.

GENERAL ASSEMBLY OF NORTH CAROLINA

1983 SESSION (REGULAR SESSION, 1984)

RATIFIED BILL

CHAPTER 1112
HOUSE BILL 738

AN ACT AUTHORIZING STUDIES BY THE LEGISLATIVE RESEARCH COMMISSION, AUTHORIZING ADDITIONAL STUDIES, AND MAKING VARIOUS APPROPRIATIONS FOR STUDIES.

The General Assembly of North Carolina enacts:

Sec. 12. Commission on a Cafeteria-Style Benefi Program for Teachers and State Employees (H. J. R. 1032-Hayden).

(a) The Commission on a Cafeteria-Style Benefi Program for Teachers and State Employees is hereby created.

(b) The Commission on a Cafeteria-Style Benefi Program for Teachers and State Employees shall study t feasibility of establishing a cafeteria-style benefits progr for all teachers and State employees. The Commission shall stu the current benefits offered by the State to determine which, any, of these benefits could be incorporated into a cafeteri style benefits program and shall also study benefits not offer by the State to determine whether additional benefits could offered through a cafeteria-style benefits program. T Commission shall determine the dollar amount of benefits th could be allocated to each employee under a cafeteria-sty benefits program and the cost to the employee of each benef that could be included in this type program. The Commissi shall consider whether any restrictions, such as a specifi waiting period or a physical examination, should apply to t selection of any benefits.

(c) The Commission shall be composed of the followi 10 members:

(1) five Representatives appointed by the Speaker the House;

(2) five Senators appointed by the President P Tempore.

(d) All appointments shall be made not later th August 1, 1984. All vacancies shall be filled by the appointi officer. The Speaker and the President Pro Tempore shall ea choose a cochairman from the membership of the Commissio Either cochairman may call the first meeting of the Commission.

(e) Members of the Commission shall receive subsisten and travel allowances at the rate set forth in G.S. 120-3.1.

(f) The Legislative Services Commission shall provi staff assistance to the Commission. The Commission may hold i meetings in the legislative buildings.

(g) The Commission shall make a report to the Gener Assembly on or before February 15, 1985, containing t recommendations of the Commission as to the need, if any, f changes in existing statutes or the need for new statutes. T Commission shall terminate upon submission of its report.

(h) There is appropriated from the General Fund to t General Assembly the sum of ten thousand dollars ($10,000) f the 1984-85 fiscal year to implement the provisions of th section.

Subject of study: Cafeteria-style benefits for teachers and State employees

Authorization for study: H.J.R. 1032, and § 12, Chapter 1112, 1983 Session Laws

Entity to conduct study: Commission on a Cafeteria-Style Benefits Program for Teachers and State Employees

Report to and date: General Assembly, on or before February 15, 1985

Members:

President Pro Tempore's Appointments

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Appendix C

Persons Making Presentations
to the
Commission on a Cafeteria Style Benefits Program
for Teachers and State Employees

October 12, 1984

Sam Badgett, Director of Employee Relations, Office of State Personnel

Jim Burch, Deputy Assistant Superintendent of Personnel Services, Department of Public Instruction

Durward F. "Butch" Gunnells, State Employees Association of North Carolina

Pat Mullen, North Carolina Association of Educators

Raymond Sarbaugh, North Carolina Association of School Administrators

Jan Halen, North Carolina School Boards Association

November 20, 1984

Tom Cavanaugh, Consulting Actuary and Director of Services for Governmental Systems, Buck Associates

Murray Hulse, Benefit Consultant, Buck Associates

Yvonne Brannon, Research Director, Urban Center at North Carolina State University

J. Thomas Lundy, County Manager, Catawba County

Norman F. Crews, Executive Vice President, Industrial Insurance Management Corporation, Catawba County

December 14, 1984

Nellie Riley, Office of State Personnel

Appendix D

A BILL TO BE ENTITLED

AN ACT TO CONTINUE THE WORK OF THE COMMISSION ON A CAFETERIA-STYLE BENEFITS PROGRAM FOR TEACHERS AND STATE EMPLOYEES AND TO APPROPRIATE FUNDS TO CONTINUE THE STUDY.

Whereas, Section 12 of Chapter 1112 of the 1983 Session Laws created the Commission on a Cafeteria-Style Benefits Program for Teachers and State Employees to study the feasibility of establishing a program of flexible benefits for North Carolina; and

Whereas, the Commission, after four meetings, determined that it was feasible to implement a system of flexible benefits for state employees and teachers, but that the form and content of the program required considerable additional study; and

Whereas, the Commission after reviewing the current federal income tax provisions and regulations and the proposed flat tax plans, including the United States Treasury Department's plan which would have a dramatic effect on the utility of a cafeteria-style benefits program, has determined that the implementation of any program should be delayed until the tax consequences of the program can be determined; and

Whereas, the Commission determined that it should be increased by the addition of four members, two appointed by the Speaker of the House of Representatives and two appointed by the President Pro-Tem of the Senate, who should have expertise in the area of employee benefits or cafeteria-style benefit programs; and

Whereas, the Commission should be adequately funded to allow it to return to the General Assembly in 1987 with a cafeteria-style benefit program in the proper form for ratification; NOW, THEREFORE,

The General Assembly of North Carolina enacts:

Section 1. Subsection (c) of Section 12 of Chapter 1112 of the 1983 Session Laws is rewritten to read:

"(c) The Commission shall consist of the following 14 members:

(1) five Representatives appointed by the Speaker of the House of Representatives;

(2) five Senators appointed by the President Pro-Tem of the Senate;

(3) two non-legislator members appointed by the Speaker of the House of Representatives;

(4) two non-legislator members appointed by the President Pro-Tem of the Senate;

The four non-legislator members shall be people with expertise in the area of employee benefits or cafeteria-style benefit programs."

Sec. 2. The first sentence of Subsection (d) of Section 12 of Chapter 1112 of the 1983 Session Laws is rewritten to read: "All appointments shall be made within 30 days of the ratification of this act."

Sec. 3. Subsection (e) of Section 12 of Chapter 1112 of the 1983 Session Laws is rewritten to read: "(e) Members of the Commission who are legislators shall receive subsistence and travel allowances at the rate set forth in G.S. 120-3.1. Members of the Commission who are non-legislators shall receive subsistence and travel allowances at the rate set forth in G.S. 138-5."

Sec. 4. Subsection (g) of Section 12 of Chapter 1112 of the 1983 Session Laws is rewritten to read: "(g) The Commission shall report to the 1987 Session of the General Assembly."

Sec. 5. There is appropriated from the General Fund to the General Assembly the sum of twenty-five thousand dollars ($25,000) for the fiscal year 1985-86 for the purpose of continuing the work of the Commission on a Cafeteria-Style Benefits Program for Teachers and State Employees for the 1985-1987 biennium.

Sec. 6. This act shall be effective upon ratification.